Why Financial Services are Important for Poor People

If you're poor, you don't have much money. Most of what you have is spent on food and cooking.

So, every time you need a sum of money for some other thing, you don't have the money available in your pocket or home.

So what do you do?

- you go without (which happens very often)
- you sell off assets (which are scarce and hard to replace)
- **or you dip into past income or future income**

To use the third option:

- **either you must have savings you can draw on (savings come from past income)**
- **or you must get an advance against future savings (that is, get a loan that you promise to pay back by making savings in the future)**

Financial services for the poor are mostly about how to do that trick – how to save from the past and save in the future.

Saving (the act of choosing not to spend) is the fundamental act of money management.

Because poor people have small incomes that are often irregular or unreliable, they need perform this trick very often, so ***it can be argued that poor people need financial services even more than rich people do***

Why Poor People Need Usefully Large Lump Sums of Money

Throughout their lives, there are many times when the poor need sums of money larger than what is immediately available to them.
I suggest three main categories of such occasions:

- ***Life cycle needs***.

for example: birth, death and marriage, education and home-making, widowhood, old age and death, and the need to leave something behind for one's heirs.

- ***Emergency needs***.

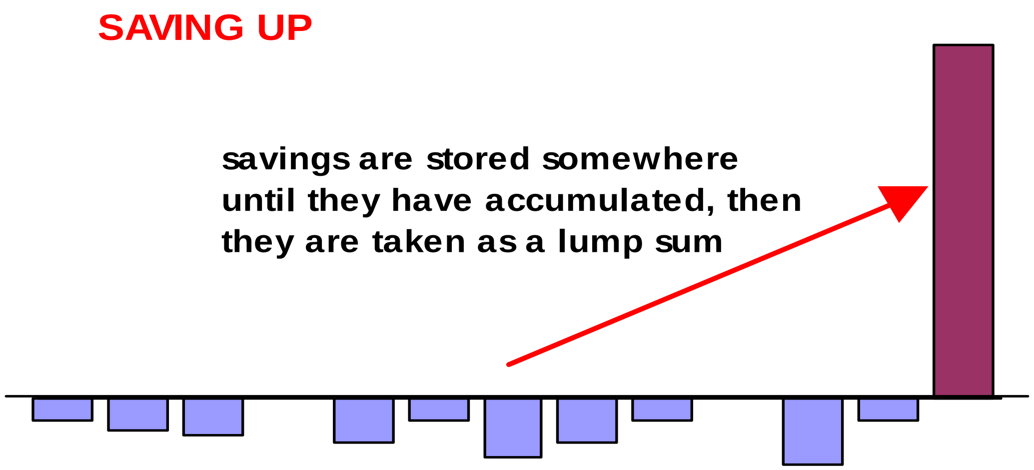
for example: impersonal emergencies like floods, cyclones, and fires, and personal emergencies like illness, accident, bereavement, desertion and divorce.

- ***Opportunities***.

for example: starting or running businesses, acquiring productive assets, or buying life enhancing consumer durables such as fans, televisions and refrigerators.

The only reliable and sustainable way for the poor to get hold of these large lump sums of money is to *build them from their savings*.

The Three Most Common Ways of Turning Savings into Usefully Large Lump Sums



Store the savings until they accumulate into a lump sum. The main *advantage* is that the lump sum is then free of any obligation. The main *problem* is that it is hard if you're poor to find a safe place to store savings.

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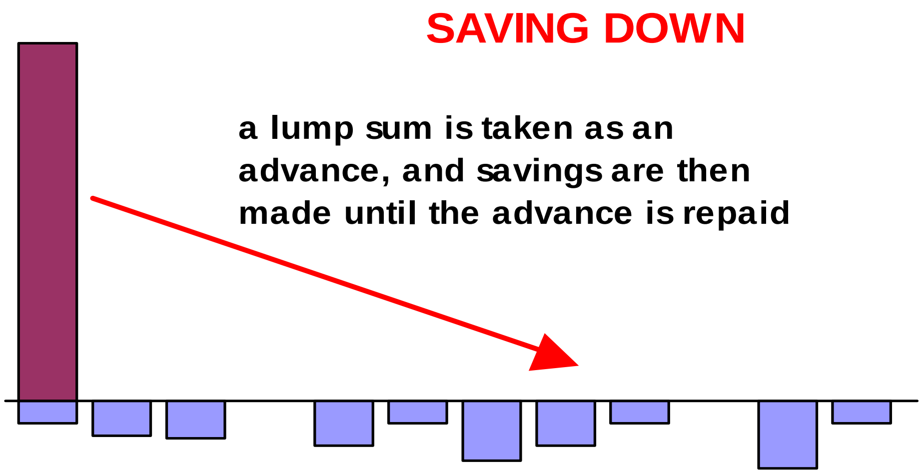

Use your saving power to repay an ‘advance’ taken from someone else. The main *advantage* is that you get the lump sum immediately, before the saving process. The main *problem* is that it is hard if you’re poor to find someone to give you an advance.

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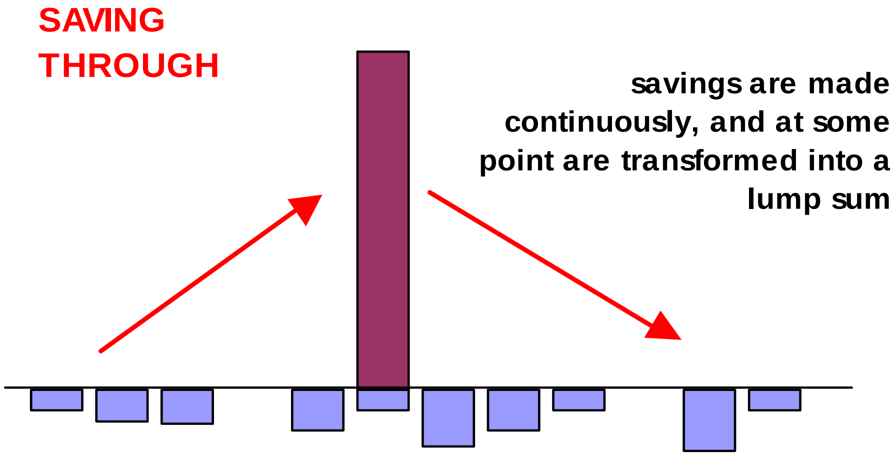
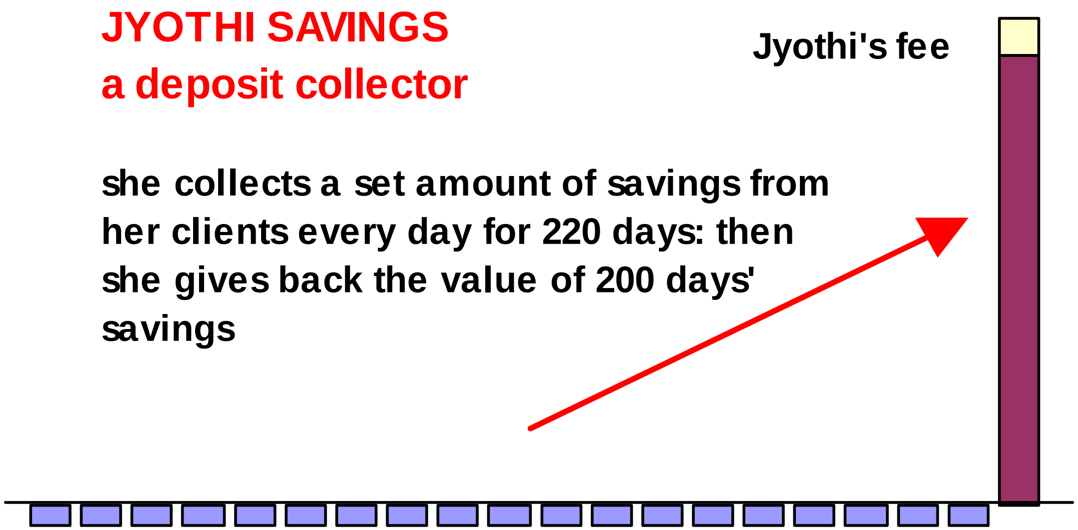


Make savings continuously, and take the corresponding lump sum at some point in this process. The main *advantage* is that this 'rhythm' of continuous savings suits many poor people. The main *problem* is that not all poor people can join schemes (such as ROSCAs or insurance) that allow them to 'save through'.

Clients get a 'savings card' with the 220 cells shown on it.

Jyothi's fee works out at 9% of the total savings, or as a negative interest rate of about 30% a year.



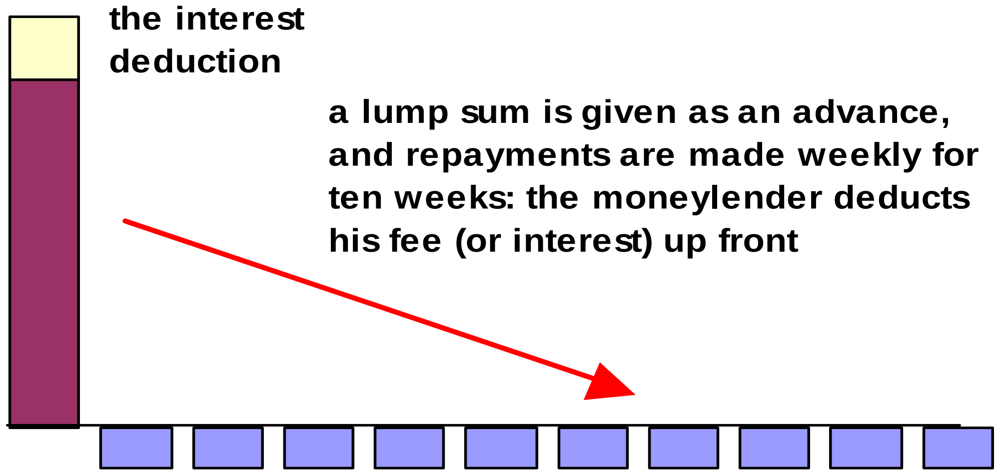
Slum women are very keen to use a reliable deposit collector like Jyothi.

Where else can they save up the usefully large sums they so often need?

In a slum near where Jyothi works, I found an urban moneylender who gives small loans to poor people and takes the money back in ten equal weekly instalments.

The clients use the lump sums for the same sort of purposes as Jyothi's clients do with their savings.

URBAN MONEYLENDER



The moneylender charges more than Jyothi. His fee is about 15% of the amount saved. As a percentage interest rate, it works out to about 160% a year.

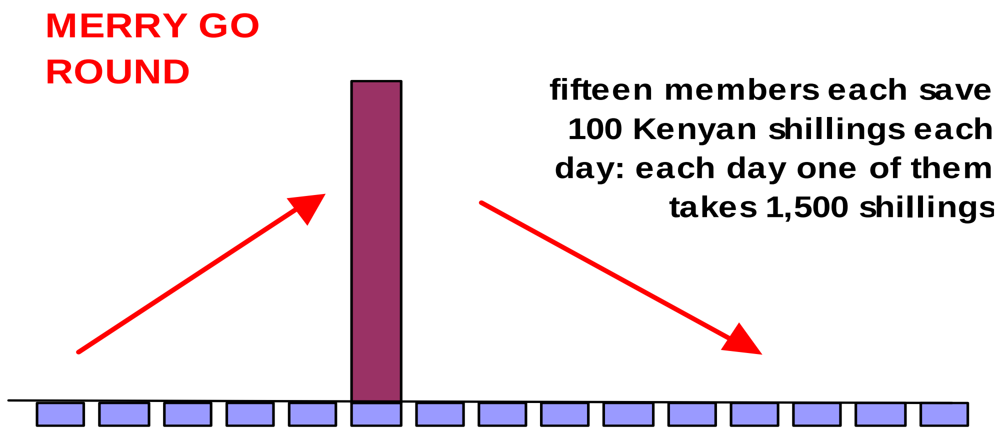
But then the moneylender does more than Jyothi:

* he has to find the money to finance his business
* he has to take the risk that the borrowers won't repay
* he has to decide the amount that can be lent

Mary belongs to a Merry Go Round, or ROSCA, in the slums of Nairobi.

She puts in 100 shillings a day, and takes out 1,500 shillings every fifteen days.

The Merry Go Round is run as a private club, so there are no fees or interest to pay – but Mary and her fellow members have to make sure they have the discipline and trust to run it.

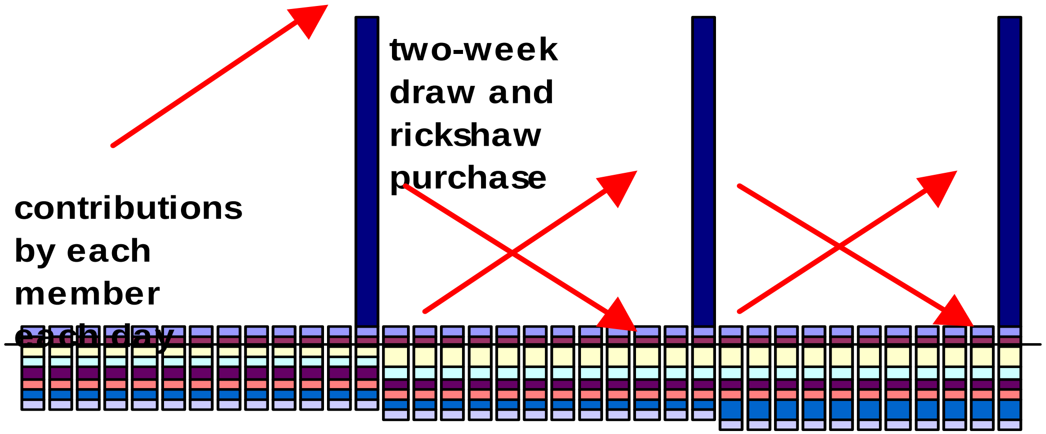


When I met her in 1998 Mary had been in her Merry Go round for two and a half years. She is 'serial number seven' – she always gets her prize on the seventh day of the round.

Mary is a deserted mother. She runs a tiny business selling vegetables from her hut. Her whole stock is worth about 1,500 shillings. When she has to run her stock down because of some need for a lump sum – such as medicine for her son – she can always re-stock within fifteen days if she is faithful to her Merry Go Round.

RICKSHAW LOTTERY ROSCA

Poor people are often **inventive** about how they turn their savings into lump sums.



A lottery ROSCA decides who gets the prize by chance rather than by consensus.

In Dhaka, Bangladesh, poor men up from the villages often drive rickshaws. They run these ROSCAs without help from any outsider.

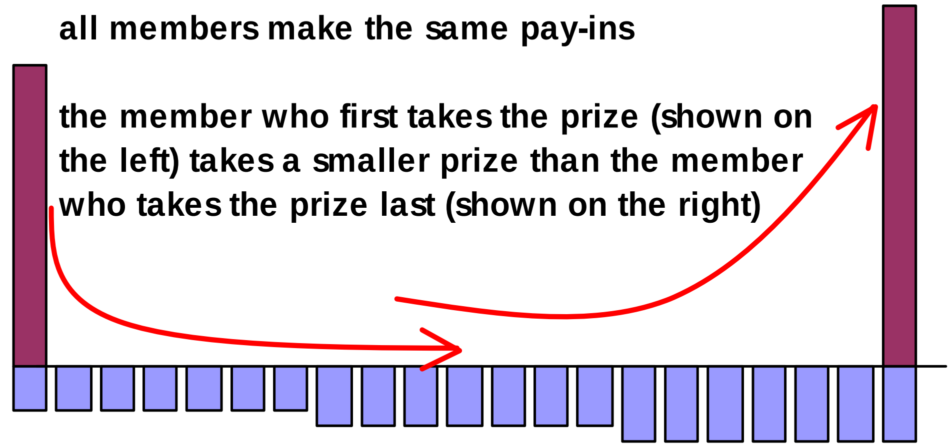
They get together in groups. Each man contributes a small fixed amount at the end of each day. As soon as there is enough money to buy one rickshaw they do so. The rickshaw is then awarded by lottery to one of the group.

As soon as you have received your rickshaw you start paying double. This is ‘fair’ as you don't have to hire a rickshaw any more. This speeds up the process of the ROSCA, which helps to guard against members running away after getting their rickshaw.

Informal financial devices are often good at setting fair prices for the services they offer. They are also automatically sustainable.

An Auction ROSCA sets the price of the pay-out automatically – without the members needing to sit down and agree on an interest rate. Those who take the prize early 'save down' and pay for the privilege, and those who take the prize late 'save up' and get rewarded for it.

AUCTION ROSCA



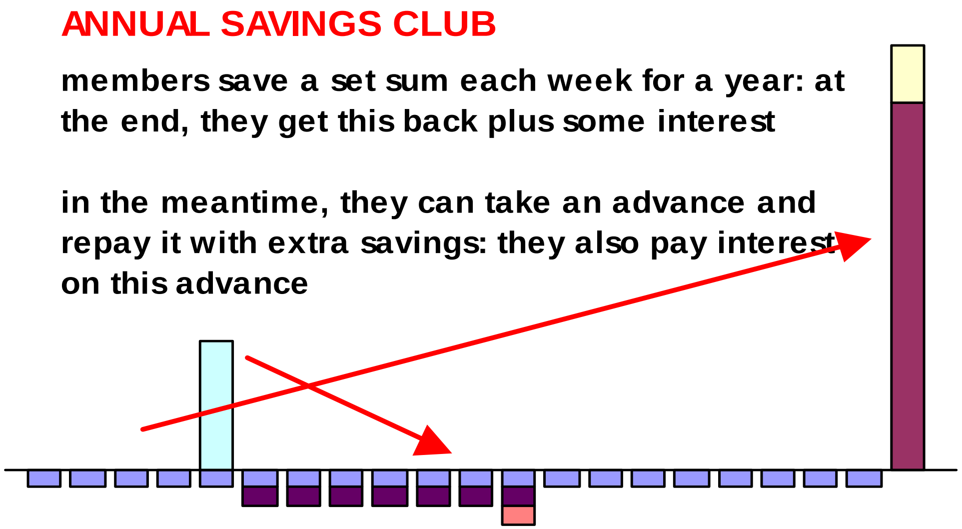
At the first round, members bid for the prize. Suppose there are 20 members, and each puts $5 on the table. There is a total of $100 on the table. The member who wins the bidding wins by agreeing to pay, say, $20 for it. The $20 is returned to the members – so in effect each member only has to pay $4 (instead of $5). The 'winner' takes away $81 ($100 less the $20 bid plus the $1 share of the bid money).

The member who doesn't bid and agrees to wait until the end before taking the prize gets the whole $100 on offer that round, plus his share of the bid money.

Informal devices are often **time-bound** and incorporate automatic **checks** on management. They have ways of letting people of different capacity to share the same scheme.

An Annual Savings Club offers both ‘saving up’ and ‘saving down’.

Members save up for a year, depositing a set sum each week. Members may have more than one ‘name’ if they want to save more than the minimum. They can’t withdraw until the end of the year, when they get all their savings back plus interest.



The interest is available because in the meantime some members take advances, and pay interest on those advances.

Typically, members pay 4% a month for advances, and on their savings they get 600 rupees back for each 10 rupees saved per week (an interest of 80 rupees).

At the end of the year, every member knows how well the club worked – either they got their savings back, plus interest, or they didn't. I call this an ‘action audit’.

Time-bound Informal Clubs

ROSCAs are by definition time-bound

they last as many 'rounds' as there are members

many of the best ASCAs are also time-bound:

- **Annual Savings Clubs last a year**

although they often use repeating cycles

These features allow them to adapt to the needs of their members as they change over time, and to overcome various risks - but it makes it difficult for the clubs to serve

LONG-TERM NEEDS

There are two main ways round this disadvantage:

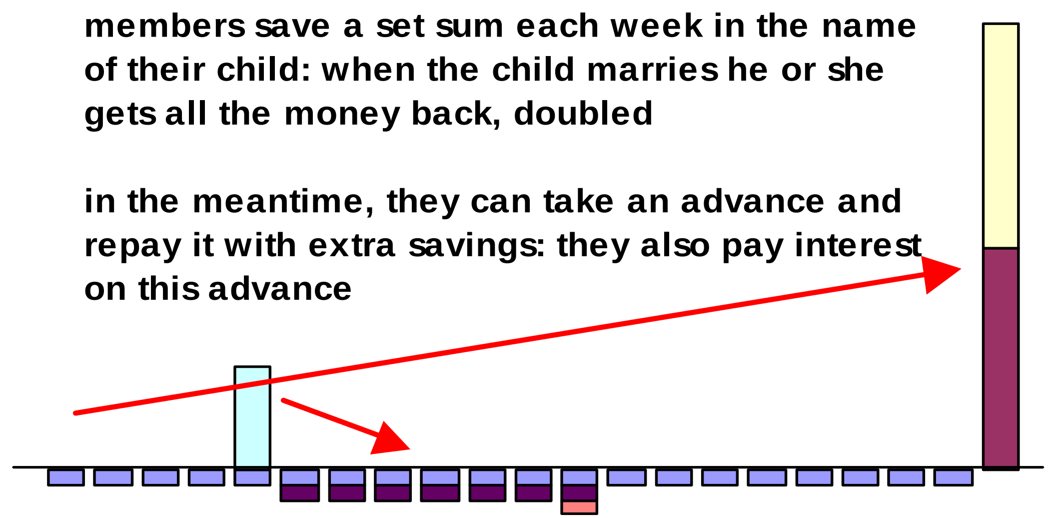
1. put your club into the hands of a permanent institution
2. turn your club into a Credit Union

You don’t *have* to be a professional MFI to run good financial services for the poor. This is true even of **long-term services**. Such services may answer **social** needs.

A Marriage Fund is a ‘long term’ savings club that locks savings in for at least 15 years.

It is designed to help with the high cost of marriages in India. But the principle can be used for many other long term needs.

MARRIAGE FUND

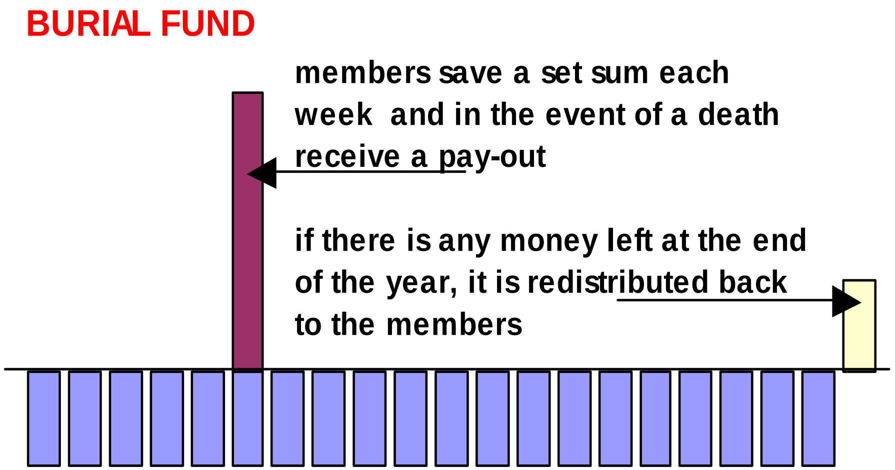


As in an Annual Savings Club, the interest paid to savers comes from the interest paid by those who choose to take advances. The club is automatically sustainable.

If you work it out, you will see that doubling the savings over fifteen years or more requires only a modest interest rate. Such clubs usually charge 4% a month for advances.

These clubs are usually run by stable organisations whose main function is not financial services – churches, mosques, temples, welfare clubs and trade associations.

Informal devices rarely serve ‘**insurance’** needs. Here’s an exception. It features action audits, is friendly to rich and poor, and solves the time-bound problem by annual repeating cycles.



In a Burial Fund the weekly contribution is usually very small, allowing very poor people to participate. Richer members simply pay for two or more ‘names’.

The Burial Fund incorporates true ‘pooling’ of contributions. You only get a pay-out if someone in your household dies. All other devices seen so far involve ‘reciprocal’ pay-outs. Among financial services devices run by poor communities, pooling is less common than reciprocity.

Burial Funds run on a yearly cycle. At the end of the year any excess money is divided up and returned to the members – this provides an incentive to join again for the next year, and acts as an ‘action audit’.